

In the Matter of:	:	CFTC Docket No. 02-01
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	:	
CLAY KRHOVJAK and PAUL	:	ORDER MAKING FINDINGS
COCHRAN	:	AND IMPOSING REMEDIAL
	:	SANCTIONS AS TO CLAY
	:	KRHOVJAK AND PAUL
	:	COCHRAN
Respondents.	:	
	:	

On October 26, 2001, the Commodity Futures Trading Commission (“Commission”) filed a one-count Complaint and Notice of Hearing (“Complaint”) against Clay Krhovjak and Paul Cochran. The Complaint charged Respondent Clay Krhovjak (“Krhovjak”) and Paul Cochran (“Cochran”) with violating or having violated Sections 4b(a)(i)-(iii) of the Commodity Exchange Act, as amended (the “Act”), 7 U.S.C. §§ 6b(a)(i)-(iii) (2001).

In order to dispose of the remaining allegations and issues raised in the Complaint, Respondents Krhovjak and Cochran have submitted offers of settlement that the Commission has decided to accept. Without admitting or denying the allegations in the Complaint or the findings of fact in this Order Making Findings and Imposing Remedial Sanctions ("Order"), Respondents Krhovjak and Cochran acknowledge service of this Order, and consent to the use of the findings herein in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party.¹

1 Krhovjak and Cochran do not consent to the use of their Offers or this order as the sole basis for any other proceeding brought by the Commission other than a proceeding to enforce the terms of this Order, nor do Krhovjak or Cochran consent to the use of the Offer, or the findings in the Order consented to in the Offer, by any other person or entity in this or any other proceeding. The findings made in the Order are not binding on any other person or entity named as a defendant or respondent in any other proceeding.

III.

The Commission finds the following:

A. SUMMARY

From at least June 28, 1996 through October 29, 1996, Krhovjak and Cochran, both employees of Coastal Corporation (“Coastal”), together with other participants who are not respondents in this action, engaged in a fraudulent scheme to misappropriate futures trades of, and to trade ahead of futures trades placed by, Coastal, its subsidiaries or divisions.

The profits from this allocation scheme were later distributed among the scheme’s participants, including Krhovjak and Cochran. Respondents and the other participants generated illegal profits for themselves of at least \$89,228.

B. SETTLING RESPONDENTS

Clay Krhovjak resides in Belleville, Texas. Krhovjak worked for Coastal in its commodity futures trading division as an Assistant Vice-President during the relevant time period. Krhovjak has never been registered with the Commission in any capacity.

Paul Cochran resides in Houston, Texas. Cochran was an Assistant Vice-President in Coastal’s commodity futures trading operation in Houston. Cochran has never been registered with the Commission in any capacity.

C. FACTS

Coastal’s business, directly and through its various subsidiaries and divisions, includes petroleum refining, marketing and distribution, natural gas transmission and storage, and oil and gas exploration and production. Coastal trades in the futures markets primarily to hedge the value of its positions in raw materials and refined products. Coastal merged with El Paso Corporation (“El Paso”) and El Paso is the surviving corporation.

Between at least June 28, 1996 and October 29, 1996 (the “relevant time period”), Coastal traded in crude oil, heating oil and natural gas futures contracts on the New York Mercantile Exchange (“NYMEX”), primarily to hedge the value of its positions in raw materials and refined products. Coastal’s in-house traders frequently used a NYMEX floor brokerage entity known, at various times, as Refined Energy, Inc., Refined Executions, Inc., Refined Energy Executions, Inc., Fine Energy, Inc., Fine Energy Executions, Inc., and Fine Executions, Inc. (collectively “Refined”) to execute Coastal’s trades.

During the relevant period, Krhovjak and Cochran were Assistant Vice Presidents of Coastal’s commodity futures trading operation. Krhovjak and Cochran performed risk

analysis for Coastal and made determinations concerning the types and quantities of energy futures that Coastal would buy and sell on commodities markets to hedge its inventory. Krhovjak and Cochran were responsible for entering Coastal's large volume of energy futures orders to the floor of the NYMEX, and placed futures orders for Coastal virtually daily by telephone.

During the relevant period, Respondents and an individual who owned Refined agreed to misappropriate profitable trades belonging to Coastal by (i) allocating profitable transactions intended for Coastal to accounts they controlled; (ii) allocating unprofitable and less profitable transactions to accounts controlled by Coastal; and (iii) using advance knowledge of Coastal's impending trading activity in the futures markets to trade ahead of anticipated resultant price movements.

The profitable, stolen Coastal trades were directed to an account in the name of Ocean East, Ltd. ("Ocean East"). The Ocean East account was controlled by another participant in the scheme.

Krhovjak and Cochran traded ahead of Coastal's trades by using their positions as traders for Coastal to obtain advance knowledge of trades Coastal planned to make on any given day. Krhovjak and Cochran then deliberately purchased and sold futures contracts for accounts controlled by their confederates while holding executable Coastal orders, thus taking the same side of the market as Coastal. As a result, Krhovjak and Cochran received better fills than Coastal did. Profits from Respondents' trading ahead activities were also directed to the Ocean East account.

Krhovjak and Cochran misappropriated Coastal's trades by means of wrongful allocations or trading ahead on the following days: June 28, July 3, July 9, July 10, July 31, August 7, August 23, October 28, and October 29, 1996. As a result of these trades, Respondents and the other scheme participants obtained, jointly and severally, approximately \$89,228 in stolen profits from trades belonging to Coastal. Krhovjak and Cochran received their share of the profits out of the Ocean East accounts by means of cash payments, and payments for entertainment, travel and gifts.

D. LEGAL DISCUSSION

1. Krhovjak and Cochran Fraudulently Allocated Commodity Futures Trades Belonging To Coastal

Sections 4b(a)(i)-(iii) of the Act prohibit any person from cheating, defrauding, willfully deceiving or making false reports to, or attempting to cheat, defraud, or willfully deceive or make false reports to, other persons in, or in connection with, the purchase and sale of commodity futures contracts, for or on behalf of another person (in this instance, Coastal).

Krhovjak and Cochran fraudulently allocated profitable trades belonging to Coastal to accounts controlled by other scheme participants and made replacement trades at a worse price to cover up their allocations, and illegally traded ahead of Coastal. Section 4b(a) prohibits the fraudulent allocation of winning and losing trades. *In re Lincolnwood Commodities, Inc.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,986 at 28,246 (CFTC Jan. 31, 1984) (respondents allocated winning day trades to their account and losing day trades to customers' accounts); *In re GNP Commodities, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,206 (CFTC Aug. 11, 1992) (allocating winning trades to respondents' accounts and losing trades to customer's account violates Section 4b); *In re Nikkhah*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,129 at 48,879 (CFTC May 12, 2000) (allocating trades to the benefit of one customer and to the detriment of another violates Section 4b). These kinds of allocations violate Section 4b(a) because arbitrarily allocating winning trades to one account and losing trades to another account is unfair and deprives the customer of a fair opportunity for profitable trades. *In re Nikkhah*, ¶ 28,129 at 49,885.

Krhovjak and Cochran also willfully made false reports to Coastal through internal trading reports that materially misreported the prices at which Coastal's orders were executed, and willfully deceived Coastal regarding the handling of its orders and the executions thereof. Willfully making false, material statements to another regarding the status of their commodity trading violates Section 4b(a)(ii) of the Act. *See CFTC ex. rel. Kelly v. Skorupskas*, 605 F. Supp. 923, 933 (E.D. Mich. 1985).

To find that Krhovjak and Cochran cheated, defrauded, or willfully deceived Coastal, a court must find that they misrepresented or omitted to state a material fact. *See Saxe v. E.F. Hutton & Co.*, 789 F.2d 105, 110-11 (2d Cir. 1986); *Hammond v. Smith Barney Harris Upham & Co.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,617 at 36,657-59 (CFTC Mar. 1, 1990). A statement is material if it is substantially likely that a reasonable investor would consider the matter important in making an investment decision. *In re R&W Technical Services, Ltd.*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,582 at 47,744 (CFTC March 16, 1999), *aff'd in relevant part*, 205 F.3d 165, (5th Cir. 2000). In general, all manner of misrepresentations of material fact regarding futures transactions violate the antifraud provisions of the Act. *See id.*

Section 4b also requires that the wrongdoer act with scienter. *See Drexel Burnham Lambert, Inc. v. CFTC*, 850 F.2d 742, 748 (D.C. Cir. 1988). A finding of scienter can be supported by proof of recklessness and by inferences from circumstantial evidence. *CFTC v. Savage*, 611 F.2d 270, 283 (9th Cir. 1979); *In re JCC, Inc.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,080 at 41,579 (CFTC May 12, 1994), *aff'd sub nom. JCC, Inc. v. CFTC*, 63 F.3d 1557 (11th Cir. 1995).

Krhovjak and Cochran's improper trade practices constituted fraudulent acts because they deprived Coastal of its fair opportunity to achieve profitable trades, while guaranteeing risk-free profitable trades for the Respondents and the other scheme participants. Their false internal reports about the trades they had misallocated further deceived Coastal about the prices, quantities and executions Coastal was receiving in its futures trades. Respondents made these fraudulent allocations and material false reports knowingly and willfully. Therefore, Krhovjak and Cochran violated Sections 4b(a)(i)-(iii) of the Act, 7 U.S.C. §§ 6b(a)(i)-(iii).

IV.

OFFERS OF SETTLEMENT

Krhovjak and Cochran have submitted separate Offers of Settlement in which they neither admit nor deny the allegations in the Complaint or the findings in the Order. Subject to the foregoing, Respondents acknowledge service of this Order and admit the jurisdiction of the Commission with respect to the matters set forth in the Complaint and the Order. They waive: (1) a hearing and all post-hearing procedures; (2) judicial review by any court; (3) any objection to the staff's participation in the Commission's consideration of the Offers; (4) all claims which they may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (1994) and 28 U.S.C. § 2412 (1994), as amended by Pub. L. No. 104-121, §§ 231-32, 110 Stat. 862-63, and Part 148 of the Regulations, 17 C.F.R. §§ 148.1, *et seq.*, relating to or arising from this action; and (5) any claim of Double Jeopardy based upon the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief.

Respondents Krhovjak and Cochran stipulate that the record basis on which this Order is entered consists of the Complaint, and the Order and findings to which they have consented in their Offers. Respondents consent to the Commission's issuance of this Order, which makes findings as set forth herein, and orders:

that Respondent Krhovjak:

- a) cease and desist from violating the provisions of the Act and the Regulations that he has been found to have violated;
- b) pay a civil monetary penalty ("CMP") of \$40,000;

- c) be permanently prohibited from trading on or subject to the rules of any registered entity; and
- d) comply with the undertakings as set forth in his Offer and incorporated in this Order;

that Respondent Cochran:

- a) cease and desist from violating the provisions of the Act and the Regulations that he has been found to have violated;
- b) pay a civil monetary penalty ("CMP") of \$30,000;
- c) be permanently prohibited from trading on or subject to the rules of any registered entity;² and
- d) comply with the undertakings as set forth in his Offer and incorporated in this Order

V.

FINDINGS OF VIOLATIONS

Solely on the basis of the consents evidenced in Respondents' Offers and prior to any further proceedings or adjudication on the merits, the Commission finds that Krhovjak and Cochran violated Sections 4b(a)(i)-(iii) of the Act, 7 U.S.C. §§ 6b(a)(i)-(iii) (2001).

VI.

ORDER

Accordingly, IT IS HEREBY ORDERED THAT:

- A. Krhovjak and Cochran each cease and desist from violating Sections 4b(a)(i)-(iii) of the Act, 7 U.S.C. §§ 6b(a)(i)-(iii) (2001);
- B. Krhovjak and Cochran each is permanently prohibited from trading for themselves or others on or subject to the rules of any registered entity, and

² Nothing in this Order shall prohibit Cochran from trading, or giving advice on trading, the proprietary commodity futures or options account(s) of any present or future employer (that has at least \$2 million in assets); provided that Cochran (a) provides his employer with a copy of this Order prior to trading or giving advice on trading such account(s), and (b) informs the Division of Enforcement within 30 days after commencing work for such an employer that involves trading or giving advice on trading by sending a letter the Director of the Division of Enforcement.

directs all registered entities to refuse Krhovjak and Cochran all privileges.

Nothing in this Order shall prohibit Cochran from trading, or giving advice on trading, the proprietary commodity futures or options account(s) of any present or future employer with more than \$2 million in assets, provided that Cochran (a) provides his employer with a copy of this Order prior to trading or giving advice on trading such account(s), and (b) informs the Division of Enforcement within 30 days after commencing work for such an employer that involves trading or giving advice on trading by sending a letter addressed to: Director, Division of Enforcement, 1155 21st Street, NW, Washington, DC 20581;

- C. Krhovjak shall pay a civil monetary penalty in the amount of Forty Thousand Dollars (\$40,000) and Cochran shall pay a civil monetary penalty in the amount of Thirty Thousand Dollars (\$30,000). Both civil monetary penalties shall be paid within ten (10) business days of the date of the Order, and such payments shall be made by electronic funds transfer to the account of the Commission at the United States Treasury or by certified check or bank cashier's check made payable to the Commodity Futures Trading Commission, and sent to Dennese Posey, Commodity Futures Trading Commission, 1155 21st Street, NW, Washington, D.C. 20581, under cover of letter that identifies Krhovjak and Cochran, respectively, and the name and docket number of this proceeding. Krhovjak and Cochran shall simultaneously transmit a copy of their respective cover letters and the forms of payment to the Director, Division of Enforcement, Commodity Futures Trading Commission, 1155 21st Street, NW, Washington, DC 20581. In accordance with Section 6(e)(2) of the Act, 7 U.S.C. § 9a(2), if Respondent fails to make payment of his penalty within fifteen (15) days of the due date, he shall be automatically prohibited from trading on or subject to the rules of any registered entity, and his registration, if any, shall be suspended automatically, until he shows to the satisfaction of the Commission that payment of the full amount of the penalty with interest thereon to the date payment has been made;
- D. Krhovjak and Cochran shall comply with their undertakings as set forth in Section III of the Offer, as follows:
1. Krhovjak and Cochran shall never apply for registration or seek exemption from registration with the Commission in any capacity, except as provided for in Section 4.14(a)(9) of the Regulations, 17 C.F.R. § 4.14(a)(9) (2001), and shall never engage in any activity requiring registration or exemption from registration, except as provided for in Section 4.14(a)(9) of the Regulations, or act as a principal, agent or officer of any person registered, exempted from

registration or required to be registered with the Commission, except as provided for in Section 4.14(a)(9) of the Regulations;

2. Neither Krhovjak nor Cochran nor any of their agents or employees shall take any action or make any public statement denying, directly or indirectly, any findings or conclusions in the Order, or the allegations in the Complaint, or creating, or tending to create, the impression that the Order, or the allegations in the Complaint, are without a factual basis; provided, however, that nothing in this provision affects Krhovjak and Cochran's: (i) testimonial obligations; or (ii) right to take legal positions in other proceedings to which the Commission is not a party. Krhovjak and Cochran shall take all steps necessary to ensure that their agents or employees, if any, understand and comply with this undertaking;

The provisions of this Order shall be effective on this date.

BY THE COMMISSION.

Dated: September 19, 2002

Jean A. Webb
Secretary to the Commission
Commodity Futures Trading Commission